Shanmugam Paramsothy v Thiagarajah Pooinpatarsan & Ors

HIGH COURT (KUALA LUMPUR) — ORIGINATING MOTION NO R1–25–42 OF 2000
RAUS J
4 AUGUST 2003

Arbitration — Award — Setting aside — Application — Whether errors of law existed — Whether resolutions passed ultra vires — Whether ward of back-salary valid

This was an application for an order to set aside an award by the learned arbitrator, or alternatively, be remitted for reconsideration by reason of the learned arbitrator erroneously stating and applying the principles of law in his award. The issues in determining whether there existed errors of law apparent on the face of the award to warrant the award to be set aside were: (i) whether the second arbitrator had failed to consider the relevant legal principle applicable in relation to a remuneration of directors; and (ii) even if he was correct, whether he fell into error in the construction of the relevant articles of association, in particular arts 82 and 83.

Held, setting aside award with costs:

(1) The second arbitrator failed to consider the relevant legal principle applicable in relation to a remuneration of directors. He should have, in the first instance, properly appraised himself of the general legal principles pertaining thereof before proceeding to construe of the articles of association. This failure affected the entire decision making process that directors could not award themselves contracts nor payments without the authorization of the company in general meeting. Therefore, it constituted a clear error of law (see paras 12, 15); *Kerr v Marine Product* [1928] TLR 292 followed.

(2) In the present case, the second arbitrator wrongly construed that the terms 'remuneration' in art 82 referred to services as a 'director' only. If so, it would have been unnecessary for the shareholder's approval for such remuneration and for it to be on a 'day to day' basis. Article 82, if properly construed, is to give effect to establish position in law that a director has no right to remuneration for services and cannot pay themselves or each other unless properly authorized by the shareholders at a general meeting (see para 18).

(3) The second arbitrator in his award held that art 83 effectively entitles the first and second respondents to the salaries they awarded themselves retrospectively. This finding is incorrect in law. While art 83 empoweres the board of directors to fix the amount payable to directors in such circumstances, it can only be in respect of matters performed in their capacity as directors. Hence, the board had no authority to fix remuneration for directors carrying out services in some other capacities, as in the present case. It was also clear that art 83, on its clear wording contemplated a prospective assignment that

is, it is subject to the directors being willing and could not therefore apply retrospectively for any services rendered in the past (see para 21).

(3) On the above reasons, the second arbitrator committed several serious errors of law and came to the wrong conclusion that the resolutions passed were not ultra vires and the award of back-salary valid (see para 24).

[Bahasa Malaysia summary

Ini adalah satu permohonan untuk satu perintah mengenepikan award oleh penimbangtara, atau secara alternatif, diremitkan untuk penimbangan semula dengan alasan bahawa penimbangtara yang bijaksana telah dengan silap telah menyatakan dan menggunakan prinsip-prinsip undang-undang yang salah dalam award beliau. Persoalan-persoalan yang menentukan sama ada terdapat kesilapan undang-undang yang nyata di muka award untuk mewarankan award diketepikan adalah: (i) sama ada penimbangtara kedua telah gagal untuk menimbangkan prinsip undang-undang relevan yang terpakai berkaitan gaji pengarah-pengarah; dan (ii) walaupun jika beliau betul, sama ada beliau tersilap dalam pembentukan perkara-perkara relevan persatuan, terutamanya perkara-perkara 82 dan 83.

Diputuskan, mengenepikan award dengan kos:

(1) Penimbangtara kedua telah gagal untuk menimbangkan prinsip undang-undang yang relevan terpakai berkaitan gaji pengarah-pengarah. Beliau sepatutnya, pertama kali, menilai dengan betul diri sendiri tentang prinsip-prinsip am undang-undang berkaitannya sebelum terus menafsirkan perkara-perkara persatuan tersebut. Kegagaln ini menjejaskan keseluruhan membuat keputusan di mana pengarah-pengarah tidak boleh mengawardkan diri mereka dengan kontrak-kontrak maupun bayaran-bayaran tanpa pemberian kuasa syarikat dalam mesyuarat umum. Oleh itu, ia membentuk kesilapan di sisi undang-undang (lihat perenggan-perenggan 12, 15); *Kerr v Marine Product* [1928] TLR 292 diikut.

(4) Dalam kes semasa, penimbangtara kedua tersilap menafsirkan bahawa terma-terma 'remuneration' dalam perkara 82 merujuk kepada khidmat-khidmat sebagai seorang 'director' sahaja. Jika begitu, ia tidak perlu kelulusan pemegang saham untuk gaji tersebut dan untuk ia berdasarkan 'day to day'. Perkara 82, jika ditafsir dengan betul, adalah untuk menetapkan kedudukan dalam undang-undang bahawa seorang pengarah tidak mempunyai hak terhadap gaji untuk perkhidmatan dan tidak boleh membayar diri mereka sendiri atau masing-masingnya kecuali diberi kuasa dengan betul oleh pemegang saham di mesyuarat umum (lihat perenggan 18).

(3) Penimbangtara kedua dalam award beliau telah memutuskan bahawa perkara 83 secara efektifnya melayakkan responden-responden pertama dan kedua kepada gaji-gaji yang telah diawardkan oleh

mereka sendiri secara kebelakang. Penemuan ini adalah menyalahi undang-undang. Sementara perkara 83 memberikan kuasa kepada lembaga pengarah menetapkan jumlah yang perlu dibayarkepada pengarah-pengarah dalam keadaan sedemikian, ia hanya berhubung perkara-perkara dalam kapasiti mereka sebagai pengarah. Justeru itu, lembaga tersebut tiada kuasa untuk menetapkan gaji untuk pengarah –pengarah yang menjalankan perkhidmatan dalam kapasiti lain, seperti dalam kes semasa. Ia juga jelas bahawa perkara 83, berdasarkan perkataan-perkataannya yang nyata menunjukkan satu bakal penyerahan hak, ia tertakluk kepada pengarah-pengarah tersebut berkesanggupan dan tidak boleh dengan itu menggunakan secara kebelakangan untuk apa-apa khidmat yang telah dilakukan dahulu (lihat perenggan 21).

(4) Berdasarkan alasan-alasan di atas, penimbangtara kedua telah melakukan beberapa kesilapan undang-undang dan telah tiba kepada kesimpulan yang salah bahawa resolusi-resolusi yang diluluskan adalah tidak ultra vires dan award untuk gaji kebelakang adalah sah (lihat perenggan 24).]

Notes

For cases on setting aside of arbiration awards, see 1 *Mallal's Digest* (4th Ed, 2002 Reissue) paras 1202–1245.

Cases referred to

Future Heritage Sdn Bhd v Intelek Timur Sdn Bhd [2003] 1 MLJ 49 (refd)
Ganda Edible Oils Sdn Bhd v Transgrain BV [1998] 1 MLJ 428 (refd)
George Newman & Co, In re [1985] 1 Ch 674 (refd)
Halt Garage, Re [1982] 3 All ER 1016 (refd)
Hartela Contractors Ltd v Hartecon JV Sdn Bhd & Anor [1999] 2 MLJ 481 (refd)
Kerr v Marine Product [1928] TLR 292 (folld)
RV Postmaster-General (1876) 1 GB 658 (refd)
Shanmugan Paramsothy v Thiagarajah Pooinpatarsan & Ors [2001] 6 MLJ 305 (refd)

Legislation referred to

Arbitration Act 1952 ss 23, 24
Arbitration Act 1979 [Eng] s 1(1)
Rules of the High Court 1980 O 69

R Abraham (K Mazura with him) (Shook Lin & Bok) for the applicant.
RD Rajasingam (Lewis & Co) for the respondents.

Raus J:

[1] This is an application for an order that the arbitration award dated 24 March 2000 by the learned arbitrator to be set aside, or alternatively, be

remitted for reconsideration by reason of the learned arbitrator erroneously stating and applying the principles of law in his award. This application was made under ss 23 and 24 of the Arbitration Act 1952 ('the Act') and under O 69 of the Rules of the High Court 1980 ('the RHC').

Factual background

[2] The arbitration proceedings is pertaining to a clinic known as 'Federal Clinic' which is owned and operated by the third respondent. The applicant, the first and second respondents are directors and shareholders of the third respondent. The three of them entered into two agreements dated 28 February 1979 and 25 February 1980, which provided that any disputes and questions arising from the said agreements shall be referred to a single arbitrator. Disputes arose between the parties and arbitration proceeding were commenced before the late Dato' Ronald TS Khoo ('the first arbitrator') in March 1998. On 24 November 1989, the first arbitrator handed down an interim award, in which it was declared, inter alia, that the applicant was entitled to dividends from the third respondent.

[3] From 1990 to 1998, the first arbitrator continued to hear the parties on the issue of relief to be ordered pursuant to the finding in the interim award. While the arbitration proceedings were so pending the first and second respondent on 10 November 1992, passed a board of directors' resolution to award themselves salaries in different amounts which affected to the amount of monies in the accounts of the third respondent. A similar resolution was passed in 1997.

[4] The applicant raised the issue of 'retrospective salaries payments' before the first arbitrator who agreed to try the issue as part of the reliefs to be awarded in his final award. The issue was significant to the question of reliefs as it affected, inter alia, the total amount of monies available as reserve in the third respondent, which could be distributed by way of dividend. Sadly, the first arbitrator passed away in March 1998 and Tan Sri Harun Muhamad Hashim ('the second arbitrator'), was subsequently appointed to act in placement of the first arbitrator by the parties to conclude the arbitration including the determination of reliefs.

[5] The second arbitrator heard the submissions on the said issue of the first and second respondent awarding themselves retrospective salaries and handed down his award on 24 March 2000, holding that the retrospective award of salaries was within the authority of the board of directors of the third respondent and was therefore, valid. In view of this finding, the second arbitrator declined to grant the order sought by the applicant, namely that the first and second respondent repay the monies they had withdrawn as retrospective salaries back to the third respondent. In doing so, the second arbitrator rejected the contention which had been raised by the applicant that the 'remuneration' sought to be drawn by the directors required the approval of the shareholders at a general meeting of the company and in which the required approval had not been obtained in the present instance. Hence, the applicant made this application.

[6] During the hearing of the application before KC Vohrah J (as he then was) it appears that, counsel Mr Romesh Abraham for the applicant abandoned his reliance on s 23 of the Act (on misconduct of arbitrator on award being improperly procured) and on the Act. He informed the court that he was applying to set aside the award solely on the ground that there was an error on the face of the award. Counsel Mr RD Rajasingam, for the respondents, then raised a preliminary issue, that is, whether the applicant may rely on an error on the face of the record to set aside an award of the second arbitrator. It was argued that the Act does not provide for such remedy and therefore, the remedy could not be engrafted on the Act.

[7] KC Vohrah J in overruling the objection held that the courts in Malaysia have had regularly considered arbitration applications on the basis that the remedy of error on the face of the award is available for consideration under the Malaysian law. According to his Lordship, the availability of the common law remedy is so deeply entrenched in Malaysian law that short of a provision similar to s 1(1) of the English Arbitration Act 1979 (which provides that the High Court should not have jurisdiction to set aside or remit and award in the arbitration's agreement on the grounds of errors of fact or law on the face of the award) Malaysian courts have the jurisdiction to set aside an award on the ground of error of law on the face of the award (see *Shanmugan Paramsothy v Thiagarajah Pooinpatarsan & Ors* [2001] 6 MLJ 305).

Error of law on the face of the award

[8] In *Ganda Edible Oils Sdn Bhd v Transgrain BV* [1998] 1 MLJ 428, the Supreme Court (now the Federal Court) referred to the following passage in *Halsbury's Laws of England* (4th Ed) Vol 2 para 623 as to what constitutes 'an error of law on the face of the award':

> An arbitrator's award may be set aside for error of law appearing on the face to it, though the jurisdiction is not lightly to be exercised. Since question of law can always be dealt with by means of a special case, this is one matter that can be taken into account when deciding whether the jurisdiction to set aside on this ground should be exercised. The jurisdiction is one that exists and common law independently of statue. In order to be a ground for setting aside the award, an error in law on the face of the award must be such that can be found in the award, or in a document actually incorporated with it, some legal proposition which is the basis of the awards and which is erroneous.

[9] If a specific question of law is submitted to the arbitrator for his decision and he decides it, the fact that the decision is erroneous does not make the award bad on its face so as to permit its being set aside, and where the question referred for arbitration is a question of construction, which is, generously speaking, a question of law, the arbitration's decision cannot be set aside only because the court would itself have come to a different conclusion; but if it appears on the face of the award that the arbitrator has proceeded illegally, as, for instance, by deciding on evidence which was not admissible, or the principles of construction which the law does not

countenance, there is error of law which may be ground for setting aside the award.

[10] In a more recent case, *Hartela Contractors Ltd v Hartecon JV Sdn Bhd & Anor* [1999] 2 MLJ 481, the Courts of Appeal recognized that the jurisdiction of the ordinary courts in the environment of private arbitration stems from statue and common law.

Findings

[11] In this case, the central issues that called for determination is whether there are errors of law apparent on the face of the award to warrant the award to be set aside. It would be noted from the award that the retrospective salary increases awarded by the first and second respondents were upheld as valid by the second arbitrator on the grounds that such increases were within the authority of the board of directors and not by the third defendant in a general meeting. It is implicit, in this finding, that the second arbitrator held that art 83 of the articles of association of the third defendant was the operative and governing provision of the salary increases and not art 82.

[12] I am of the view that the findings in the award contain several serious errors of law. Firstly, the second arbitrator failed to consider the relevant legal principle applicable in relation to a remuneration of directors. It appears to me the second arbitrator in determining the issue, sought to do by way of brief examination of the relevant articles of association of the third respondent company and no more. The second arbitrator should have, in the first instance, properly appraised himself of the general legal principles pertaining to the remuneration of directors before proceeding to construe of the articles of association. As was stated in the case of *Kerr v Marine Product* [1928] TLR 292, that the issue of remuneration of directors 'depend on the general law applicable to companies and the article of association of the particular company'. Thus, the failure to consider the general legal position of remuneration of directors affected the entire decision making process of the second arbitrator, in which is a well established principle of law that directors cannot award themselves contracts nor payments without the authorization of the company in general meeting. The principle was stated in the following term in *Kerr*'s case as follows:

> The law appears to me to be stated in a single sentence in the judgement of the Court of Appeal delivered by Lord Justice Lindley in *In re George Newman and Co*, where at p 686 he says this:
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> > 'Directors have no right to be paid for their services, and cannot pay themselves or each other, or make presents to themselves out of the company's assets, unless authorized so to do by the instrument which regulates the company or by the shareholders at a properly convened meeting'.

[13] It was not suggested before me that there was an authority by the shareholders, and the whole question is whether the directors were authorized to enter into this agreement by the instrument which regulates the company.

[14] This principle is well entrenched and has been referred to in several cases including the cases of *In re George Newman & Co* [1985] 1 Ch 674 and *Re Halt Garage* [1982] 3 All ER 1016, a case concerning the payment of remuneration to directors where the court held was effectively, a 'disguised' payment of dividend. The rationale behind this principle is that a director, as an agent of the company, stands in a fiduciary duty to the company and therefore not to act against its interest or profit therefrom. (Adams: *The Law and Practice Relation to Company Directors in Australia* (2nd Ed) at p 71).

[15] Thus, I am of the view that the failure of the second arbitrator to consider the relevant legal principles applicable in relation to directors' rights to remuneration before considering the relevant article of association constituted a clear error of law.

[16] Secondly, I am of the view, even if the second arbitrator was correct in simply seeking to construe the article of association in isolation of the relevant legal principles, the second arbitrator fell into error in the construction of the relevant articles of association, in particular arts 82 and 83. For clarity, arts 82 and 83 of the articles of association of the third respondent is reproduced which reads as follows:

> 82 The remuneration of the Directors shall from time to time be determined by the Company in general meeting. That remuneration shall be deemed to accrue from day to day. The directors may also be paid all traveling, hotel and other expenses properly incurred by them in attending and returning from meetings of the Directors or any committee of the Directors or general meetings of the Company or in connection with the business of the Company.
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> 83 If any director being willing, shall be called upon to perform extra services, or to make any special exertions in going or residing abroad, or otherwise for any of the purposes for the Company, the Company shall remunerate such director, either by a fixed sum or by a percentage of profits, or otherwise as may be determined by the Directors, and such remuneration may be either in addition to or in substitution for his share in the remuneration above provided.

[17] To me, art 82 is the appropriate and a correct article governing remuneration of a director including remuneration by way of salary. This is implicit in the wording of art 82 which refers, inter alia, to 'that remuneration shall be deemed to accrue from day to day …'. The position is well set out in *Palmer's Company Law* (1992) (5th Ed) as follows:

> Prima facie, directors of a company cannot claim remuneration, but the articles usually provide expressly for payment of it, and, where this is the case, the provision operated as an authority to the directors to pay remuneration out of the funds of the company; such remuneration is not restricted to payment out of profits.
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> Articles commonly provide that the directors shall be entitled to such remuneration as shall be voted to them in general meeting, in which case there must be a resolution duly passed by the company. If, however, the remuneration is approved by all shareholders entitled to attend and vote at a general meeting, this has the same effect as a resolution duly passed by the company in general meeting. It is not normally sufficient to show the figure taken by directors in the

> accounts, and the acceptance by the company of the accounts, and the acceptance by the company of the accounts will not in itself authorize remuneration which has not otherwise been authorized. Exceptionally, however, a resolution of the members approving the account may be a sufficient authorization, if all the members are aware that, by being asked to approve the accounts, they are being asked also to approve the remuneration.

[18] In the present case, the second arbitrator wrongly construed that the terms 'remuneration' in art 82 referred to services as a 'director' only. If so, it would have been unnecessary for the shareholder's approval for such remuneration and for it to be on a 'day to day' basis. To me, art 82, if properly construed, is to give effect to establish position in law that a director has no right to remuneration for services and cannot pay themselves or each other unless properly authorized by the shareholders at a general meeting. To construe art 82 otherwise, as the second arbitrator has done, would mean that while relatively nominal charges for directors fees and expenses require shareholder's approval, all other remuneration including the awarding of lucrative contact for services carried out by the directors, rest solely with the directors themselves who would be entitled to determine, carte blanche, the quantum of such services contacts.

[19] As Kinlay J stated in *Kerr*'s case:

> With regard to art 69 I will only say this: It refers, I think, to the remuneration of directors in respect of their work as directors, but it appears to me to confirm the view which I have taken. It would be a remarkable result if the remuneration of the directors for their work as directors was to be determined by the company in general meeting, but the directors had power to vote themselves unlimited salaries in respect of work done or proposed to be done by them outside their work as directors of the company.

[20] The second arbitrator, is also in error when he limited the interpretation of the term 'remuneration' in art 82 to refer to items such as director's fees and expenses only. To me, term 'remuneration' is a wide term intended to refer to whatever consideration a person gets for his services (see *RV Postmaster-General* (1876) 1 GB 658). This restrictive interpretation of art 82 is unsustainable when the second arbitrator in the award proceeded to hold that the very same term, that is, 'remuneration' is capable of a wider meaning including the performance of services as 'doctors' under art 83.

[21] The second arbitrator in his award held that art 83 effectively entitled the first and second respondents to the salaries they awarded themselves retrospectively. To me, this finding is incorrect in law for several reasons. Firstly, art 83 is intended to apply 'reimbursement and compensation' and not 'remuneration' which is governed by art 82. Secondly, the term 'extra services' must carry the meaning or refer to extra services in the capacity of directors that is services of an unusual or extraordinary nature as is illustrated by the terms 'or make any special exertions in going or residing abroad'. It must also follow that while art 83 empowers the board of directors to fix the amount payable to directors in such circumstances, it can only be in respect of matters performed in their capacity as directors as the

board would, otherwise, be clearly acting outside its authority in remunerating directors for services rendered in some other capacities. Hence, the board had no authority to fix remuneration for directors carrying out services in some other capacities, as in the present case, as medical practitioners in the clinic. It is also clear that art 83, on its clear wording contemplates a prospective assignment that is, it is subject to the directors being willing and cannot therefore apply retrospectively for any services rendered in the past.

[22] It is also my view that the reference to art 85 of the articles of association by the second arbitrator in the award is also not correct in that art 85 which relates to expenses incurred prior to the incorporation of the company and has no application in the present instance.

[23] The reference to cl 3(67) of the memorandum of association of the company by the second arbitrator in seeking to construe the articles of association was clearly inappropriate as the former award with the power of the company, that is, whether an action or transaction is intra vires the company's power and not, in anyway, with the division of the powers internally between the board of directors and the shareholders.

[24] On the above reasons, I am of the view that the second arbitrator committed several serious errors of law and came to the wrong conclusion that the resolutions passed were not ultra vires and the award of back-salary valid.

[25] I am fully aware of the authorities cited by the counsel for the first respondent with regard to the role of this court in dealing with the award of an arbitrator and the circumstances in which the award can be set aside, in particular the recent Court of Appeal case of *Future Heritage Sdn Bhd v Intelek Timur Sdn Bhd* [2003] 1 MLJ 49. Nevertheless, the authorities are unanimous that the court can intervene and set aside an award where on the face of it, there are serious errors of law. The present case before me, is a clear example where the arbitrator had committed serious errors of law on the face of the award. To me, this is a fit case where the award of an arbitrator can be set aside.

[26] Accordingly, the award of the second arbitrator dated 24 March 2000 is hereby set aside with costs.

Award set aside with costs.

Reported by Ezatul Zuria Azhari